

The Mudharib's Legal Responsibility for the Business Risk in Mudharabah

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Abstract

Mudharib or the entrepreneur can take the opportunity to report a lower profit or loss due to business risk. This reason allows him to be freed from the legal responsibility. Consequently, *shahibul mal* or the financier has to absorb the loss. This paper attempts to find a solution to overcome this moral hazard. This paper employs the components of the Business Judgment Rule (BJR) that analysed to compare them with the related stipulations in the Islamic law. The finding concludes that in light of the fiduciary relationship, mudharib must fulfill the fiduciary duties being equal to the concepts of *tabayyun* and *amanah* in Islam. Based on freedom of contract, the parties can agree to insert the clauses to specify such legal duties in the contract. His legal responsibility can be determined, if mudharib has made an effort to mitigate the business risk, and taking no financial benefit behind the loss. This can serve as a solution to use mudharabah contract more frequently.

Keywords: Mudharabah, Business Risk, Fiduciary Duties, Islamic Law, Legal Responsibility.

1. Introduction

In Islam, there exists an icon of financing which is needed by economic society in general. In any society, there are always two groups with different financial capabilities. The first group, like land lords in the past, had financial capabilities exceeding their needs then having extra funds, but they did not have any capability to do business. The second group had business expertise, but had no capital. Two parties of these different groups can work together in a profit and loss sharing *mudharabah* contract. The first party serves as *mudharib*, the entrepreneur, the investment manager (Hasan & Asutay, 2011), working partner (Sarker, 1999), or agent manager (Shimizu, 2012). The second party or *shahibul mal* is the capital owner or financier, or investor. The latter entrusts *mudharib* to fully manage the investment fund in a business. The common objective is to make profit which will be shared by the two based on pre-agreed percentage. Hence, the investment manager is a fiduciary and expected to conduct the business with utmost honesty, and to return the capital and the agreed portion of profit to the *shahibul mal* (Shimizu, 2012).

In the financing relationship, each of the two has different responsibility. The first, *mudharib*, has no responsibility for the business risk, but has to be responsible for his negligence, mistakes, causing a loss in the business. As quoted by Mohammad Abdul Awwal Sarker, Ibn Qudama opined that if the loss is a result of a misuse or a violation of the contract on the part of the working partner, then he alone will be liable to cover it (Sarker, 1999). It is not the case if it is because of pure business risk; he receives no compensation for his effort and time in managing the business. He loses the opportunity cost for his labor, for the basic reason that the ups and downs and the characteristics of the business are beyond his control; and *shahibul mal* loses a portion or all of his investment fund or capital. In that case, the capital owner or *shahibul mal* cannot claim any compensation for the loss from the entrepreneur or *mudharib*.

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In the risk perspective for *shahibul mal*, to ascertain the risk arising from the behavior of *mudharib* seems to be easier. Legally, any mistake, negligence or *taqshir*, default (*mukhalafatu al syurut*), or breach of agreement or *ta'addi*, or tort, done by *mudharib* tend to be easier to analyse and judge. In the legal literatures, there avail some ways to determine such behaviors of *mudharib*. On the other hand, while the business risk is always inherent in any business, it cannot be eliminated entirely.

In facing the said risk, what possibly can be done by *mudharib* or *shahibul mal* is to measure the expected level of profitability as compared to the probability of risk occurrence that might happen. Obviously, this is a business calculation. However, the case will be more difficult, if the said risk is discussed in the light of the legal context, specifically how to determine *mudharib's* legal responsibility for the loss due to business risk. Theoretically, in *mudharabah* contract, the *mudharib* is not legally responsible for the business risk. On the contrary, practically, he is the one who is managing the business all by himself. With the assumption that he is an expert in the business, surely he must know how to mitigate the risk. The important question here then is that whether or not *mudharib* can really be freed from the responsibility for the loss due to the materialization of business risk.

As a businessman, logically it is fair to expect that *mudharib* has a genuine interest to make the business profitable. Not only for the sake of his portion, but also for the sake of his reputation will be distorted if he is making a loss in the business venture. Having this in mind, *mudharib* must have a genuine interest to mitigate the risk in question, so as to minimize the occurrence of the said risk. Naturally, this fair expectation is acceptable as far as the *mudharib* has a good faith to fulfill his roles in the contract. With good faith, *mudharib* is fairly expected to utilize all his capabilities, expertise, and hence fulfill his duty of care in doing the business being financed. Objectively, this effort is to preserve his reputation and maintain the trust or *amanah* being put on him by the financier, or *shahibul mal*. With his sincere effort, business can be naturally expected to produce profit, especially in a normal business condition. In the legal context, the condition beyond the normal expectation can be specifically defined in the contract. Normally, it is covered in the *force majeure* section of a contract.

In a normal business condition, when the business being managed by *mudharib* results in a loss, he can be freed from the legal responsibility on the reason that it is the materialization of the 'business risk'. The essence whether this being the truth or not is a matter of honesty and good faith, which relate to a morality level of a person. In Abdullah Saeed's view, the standard moral that develops in many Muslim communities is not adequate for investment business (Saeed, 2004). On the other side, *mudharabah* financing contract specifically underlines the existence of honesty, transparency, good faith, business efficiency, so that the profit can be produced for both, *shahibul mal* and *mudharib*. Having no good faith, *mudharib* can evade the responsibility to compensate for the loss on a simple reason by saying it was due to risk materialization, despite the fact, he did not put his serious efforts to mitigate the risk. This is one of the vulnerabilities faced by beneficiary in a fiduciary relationship, and also a challenge (Johnson, 2014).

Theoretically and practically, *mudharib* can use that simple reason to hide the real reason of essentially being a breach of the contract. The most extreme case behind it is possibly that the fund was being side streamed to other personal purposes. On the contrary, to convince the financier, he can find any explanation to logically back up his reason for the business loss and the risk materialization. In this case, *shahibul mal* must make a special effort to find out what actually happens behind the reported loss. In the field of finance, the picture described above can fall under the definition of *moral hazard* on the part of *mudharib*. It means that one of the parties in a contract changes his attitude hidden which creates a cost burden or risk to the other party in the contract (Alon & Kellerman, 1999). Henry N. Pontell added that the party who changes his attitude has an objective to gain without any or a minimal personal risk for him (Pontell, 2005). Theoretically, *moral hazard* is related to a contract, and happens after the contract is signed. In relation to *mudharabah*, the occurrence of *moral hazard* is caused by the fact that one party in a contract being not transparent, particularly in reporting the actual business. This is a reason why *mudharabah* contract is not being used actively.

In view of the above, there could be an approach to determine whether the loss created by *mudharib* is caused by the materialization of business risk or a *moral hazard*. Basically, *mudharib* is a fiduciary who manages *shahibul mal's* investment fund in the business based on his expertise and experience. Naturally, he must put his serious efforts to utilize all his expertise and mitigate any possible risk in doing the business.

Therefore, he eventually can make the expected profit. In legal perspective, *mudharib* can be determined whether or not he fulfills his legal duties in *mudharabah* contract, which can be approached by using the modern doctrine of *Business Judgement Rule* ("BJR") deriving from the *common law* system. *Mudharabah* financing contract is a part of Islamic finance which is governed by the Islamic Holy Book or the *Al Qur'an* and the Prophet Muhammad peace be upon him (pbuh)'s authentic sayings or *hadits*, being the two main sources of Islamic law. In Indonesia, the legal bases for *mudharabah* contract are issued by The National *Syariah* Board (DSN) through its related decrees or *fatwas* with its considerations based on several *Qur'anic* verses comprising *Surah An Nissa* (*Qur'anic Surah 4 Verse 29*), *Surah Al Maidah* (*Qur'anic Surah 5 Verse 1*), *Surah Al Baqarah* (*Qur'anic Surah 2 Verse 283*), and some Propetic *hadits*.

When the *Al Qur'an* was revealed, Islam condoned the practice of *mudharabah* financing that had been done by the Arabian traders, particularly by the Quraish people. It was developed from the habits of the traders (Az-Zuhaili, 2011). In line with *Surah Al Muzamil* (*Qur'anic Surah 73 Verse 20*) that says, "And others to travel on the earth because of hoping the bounty of Allah". The interpretation of this verse by Ibnu Katsir essentially indicates that God or *Allah* acknowledges that among the people, there are some people traveling for trade, and therefore, *Allah* allows them to overcome *udzur* or hindrance by reading the easiest and shortest verses in the obligatory prayings (Alu Syaik, 2014). Further, according to Wahbah Az Zuhaili, the verse is in line with the type of activities that usually done by traders. *Mudharib* tends to travel to other locations to bring their goods for trade. The word *mudharabah* itself comes from the word *dharb*, which means to put foots on earth (Djamil, 2012). The mission behind it is to make capital to grow (Az-Zuhaili, 2011).

The Prophet Muhammad pbuh allowed the use of *mudharabah* financing. The Prophet pbuh himself practiced *mudharabah*, by taking the goods entrusted by Khadijah, among others, to Syam. As narrated by Shuhaib ra, the Prophet pbuh ever said that blessings can come from *mudharabah* (Ibnu Majah, 2013), as to acknowledge the virtues that can be created by it.

Islam underlines the importance of *mudharabah* because, among others, men can not live to fulfill their needs alone, and they have to cooperate side by side among them. Men have several limitations in life in terms of financial and other capabilities; and being as such, men always need others for supports and cooperations. That is the reasons why God instructs human beings to help each other in good deeds, not making sins or violations (*Qur'anic Surah 5 Verse 4*). This type of cooperation creates benefits for oneself and others. For one thing, it helps to use and develop one's funds productively, based on a mutual cooperation (*Qur'anic Surah 5 Verse 4*). For other thing, fundamentally, the status of capital in the form of investment fund is being equalized with the *mudharib's* capital in the form of his business expertise or acumen to include his managerial capability, time, and energy, all of which can be categorized as human capital (Soon Chong & Liu, 2007).

In Mohammad Kabir Hassan's view, human capital is defined as personal quality and capability of *mudharib* (Hassan, 1999). The mixture of both capital types economically creates productive capacity in the society, enlarging the elements of works and employment in the real sector. At the same time, *mudharabah* financing can induce the level of entrepreneurship to grow in the society.

In addition, *mudharabah* has another social function to create social benefits, because of the fairness aspect of the contract. The party who has the fund or wealth can not take profit from those who have no wealth, as in the case of *riba* or imposing interest on money lending (Warde, 2011). With *riba*, it creates inequality between the lender and borrower, but not in *mudharabah*. The contract creates the equality between the two, i.e. the fund user and owner (Shimizu, 2012). Hence, *mudharib* can realize his capabilities, efforts and energy, in order to gain a compensation in the form of profit sharing. Essentially, *mudharabah* financing activates to chanel people's fund directly and precisely for productive purposes. In this relation, Ibrahim Warde says that, Islamic bankers have a social and moral responsibility for the economic development through *mudharabah* investment fund (Warde, 2011). All of these positive contributions can be achieved, if the *mudharabah* contract is succesfully implemented in producing profit (Al Haritsi, 2014).

Mudharabah is basically a partnership contract of two partners whom, and the relationship between the partners is that of a principal and agent (Sarker, 1999). In view of risk taking, therefore, an *hadits* narrated by Ibnu Abbas Ra, that Abbas bin Abdul Muthalib says that, when investment fund is entrusted to a *mudharib*, he must follow the guidances given by the *shahibul mal*, such as not to sail crossing an ocean, or walking down ravines. Such routes obviously expose *mudharib* to certain and bigger risks. This guidance leads *mudharib* to prudentially choose the routes to travel. In facing such risk, that type of guidances can be contained in the contract to be agreed by both parties.

Such clauses are even more important to be inserted in *mudharabah mutlaqah*, whereby *mudharib* has latitude to decide by his own into what business the *shahibul mal's* investment fund will be invested (Az-Zuhaili, 2011).

However, the virtues expected from *mudharabah* can only be created, according to Ibrahim Warde, if the possibility of mistakes, negligence, frauds, conflicts of interest can be minimized (Warde, 2011). These issues rest upon the parties involved, of which they have to fulfill their rights and obligations. Naturally, the fulfillment of the rights and obligations must be spontaneous. The business partnership, *Syirkah or mudharabah*, in Islam is developed on the basis of mutual agreement, justice, mutual benefit preservation, and the culture that is in line with Islamic legal doctrines (Az-Zuhaili, 2011). These elements are centered around morality that has to be strongly maintained by both parties. The Prophet pbuh once said, " *Verily Allah commands, ' I will bless a venture by two persons which work together as long as any one is not betraying the other. If one of them betrays, I will never bless the one who betrays'*". It means the entrepreneur, *mudharib*, must be honest and can deliver his promise (At Tuwajiri, 2012).

The moral hazard described above is basically an Agency Problem in *mudharabah*. The issue here is that once the ownership and control of asset are separated, it creates the opportunity for the agent to appropriate the asset or some of its value by ways like diversion or conversion, thus violating the agent's duty of loyalty. *Mudharib* has every incentive to under report or artificially reduced declared profit (Sarker, 1999). Hence, obligations are not fulfilled by themselves only based on 'trust'. Thomas Hobbes ever says, that man is ambitious and only has an interest in himself. In Hobbes' opinion, any individual person faces many changes in his life, because of changes in taste, desires, competition for honor and respect among the individuals. Hobbes concludes, therefore, the trust level given to an individual in business must be accompanied with legal tools, that can impose sanctions whenever one party violates the law, or in breach of the agreement that he himself makes (Muldrew, 1998).

2. Methodology

Basically, this paper is qualitative in nature. It tries to analyse how the Business Judgment Rule (BJR), as a principle or doctrine, can be applied in *mudharabah* contract in light of determining the responsibility of the entrepreneur or *mudharib* for the inherent business risk. The issue here is to know whether a serious effort by *mudharib* has been made to mitigate the business risk, or simply it just represents a moral hazard whereby the *mudharib* uses the reason of business risk being materialized in order to evade the responsibility. At a minimal, if *mudharib* makes a serious effort to mitigate business risk, it is then considered that he has fulfilled the requirements of BJR. In the mean time, the related stipulations as contained in the *Al Qur'an* and the Prophetic *hadits* must be reviewed as to ascertain the application of the BJR as a concept is in congruence with the Islamic law. Hence, therefore, the related Qur'anic verses and the *hadits* must be reviewed along with the *Qur'anic* exegesis' that have been done by the Islamic authoritative scholars in the mainstream.

3. Results and Discussion

3.1 The Rights and Responsibilities of *Shahibul Mal* and *Mudharib*

In order to overcome the problems posed by Hobbes above, in the first instance which is higher in nature, *mudharib* is obligated to obey the God Comandments as revealed in the *Al Qur'an*, particularly *Surah An Nisa* (*Qur'anic Surah 4 Verse 29*), *Surah Al Maidah* (*Qur'anic Surah 5 Verse 1*), and *Surat Al Baqarah* (*Qur'anic Surah 2 Verse 283*). On the second instance, the God commandments are to be interpreted based on its equivalence in the positive law.

The rights and duties of each party in *mudharabah* contract basically follows the Qur'anic *Surah Al Baqarah* (*Qur'anic Surah 2 Verse 283*), that says any business transactions that are done not in cash must be put in writing. To overcome the Agency Problem said above, the behavioral consideration of ignorance should be incorporated in the contract. Reward attached to cooperation might induce the agent to behave honestly (Sarker, 1999), and sanction to the contrary as well. The obligation of *shahibul mal* is to invest his fund in the business, and his right is to obtain a profit sharing from the business done by *mudharib*. If the business turns out to be at loss, he takes all the risk for which he is responsible. *Mudharib* is holding the trust from *shahibul mal*, and he is responsible to apply all his capabilities as he is working for *shahibul mal*. In one sense, he represents *shahibul mal*, as he is managing the business into which *shahibul mal* fund is invested. Also, he is a partner, for which he shares a portion of the profit. If *mudharib* breaches the contract, then he is responsible to return the investment fund to *shahibul mal*.

Otherwise, *mudharib* practices *ghasab*, or taking other people's property without the owner's approval. As an example, in *mudharabah muqayyadah*, *mudharib* buys goods that are not in the contract. If the fund investment embeds losses, *mudharib* is then not responsible, as long as not because of his mistakes, negligence, or any breach or violation. Violation means any act that is not permitted; whereas negligence or mistake represents any act that is supposed to be done but not done (At Tuwajiri, 2012). In this condition, *mudharib* has no right to receive any compensation.

In doing his job, *mudharib* is obligated to follow the normal practices as done by other similar *mudharibs* in the same market. This becomes his right to follow the normal practices. Example of this is that he can buy goods at a prevailing usual market price, but he cannot buy at a price that might constitute cheating.

3.2 The Doctrine of *Business Judgment Rule*

Az Zuhaili says that, Islam is a religion of life, and the law helps people to achieve welfare as long as it does not create conflicts among them. Hence, therefore, Islam as a religion is easy, and not complicated, good habits are accepted, as long as it does not contradict the law. *Ijtihad*, or finding a new law based on the scholars' agreement with the reference to certain *Qur'anic* verses becomes a reality that cannot be denied following the society development (Az-Zuhaili, 2011). This is in line with an Islamic jurisprudence that once says that "as long as it creates benefits or virtues, and keeps away vices or damages," or *Jalbu thosyalih wa daf'u mafsidi* (Djazuli, 2012).

Based on the above principle, and with the reference to create benefit for the society, how *mudharib* manages the business, in this case to make a business decision, he can learn it from the doctrine of BJR. In the perspective of law, doctrine is opinion from well-known legal experts, which can be used as a source of law, and has a big influence for judges to solve a case (Saliman, *et.al*, 2006). Doctrine or legal principle as applied to BJR in Indonesia, according to Van Eikema Hommes, represents general bases being abstract in nature, which becomes the background of law *in concreto*, or serving as the bases to which direction of positive laws are to be made (Ali, 2015).

The doctrine of *Business Judgment Rule*, or Prinsip Pertimbangan Bisnis, already becomes a principle in Indonesia. It uses the word '*judgment*', not '*decision*', because any decision is always preceded with judgment. It makes judgment to be identical with decision. *Black's Law Dictionary* gives the following definition of BJR (Garner, 2004):

"The presumption that in making business decisions not involving direct self interest or self dealing, corporate directors act on an informed basis, in good faith, and in honest belief that their actions are in the corporation's best interest. The rule shields directors and officers from liability for unprofitable or harmful corporate transactions if the transactions were made in good faith, with due care, and within the directors' or officers' authority".

In essence, BJR represents a presumption that can protect directors or corporate officers ("*BJR presumption*") in making business decision. The conditions that must be fulfilled to include that the decision maker is free from conflict of interest, implements a standard of care by using adequate material information in making a decision, and has rational bases in making such decision. In addition, the decision which is made must be within his authority and not being tainted with managerial fraud or self dealing, or not representing gross negligence (Triem, 2007), or not at all being a complete absence of care, or abuse of discretion, as well as not violating positive law. The most important measure is that the decision maker is not interested in the decision, and it does involve his personal interest in the decision making, or no *self dealing*. *Self dealing* means a fiduciary using his authority, or doing a transaction for his personal interest, and not for the party he represents (Brandson, 2002).

BJR represents as a procedural law to give direction how an allegation is made and as served as a material for legal certainty. As a procedural law, the first burden of proof must be carried by shareholder plaintiff who deny the "*BJR presumption*". Therefore, shareholder plaintiff has to provide evidences to prove that the alleged director, in making decision, violates one of the three components of fiduciary duties: duty of good faith, duty of care, dan duty of loyalty. However, in term of material substance, if the plaintiff is not successful in carrying the burden of proof needed, BJR presumption prevails, so that it protects the alleged director from any damage resulting from the alleged decision (Bainbridge, 2005).

The principle of BJR provides directors to use his judgments needed in making business decision, or in managing a corporate business. This authority is revealed and stated in the corporate deeds; and the implementation is broadly given by court to directors, as far as the decision contains honesty, unbiased, and honestly implemented. If fulfilled, then the court will not investigate the substance of the decision made.

However, to the contrary, court will investigate the alleged directors' decision, from the other side, that is (Johnson, 2000): (a) whether or not the decision represents fraud, or law violation, *ultra vires*, or a *waste*; (b) whether or not fulfilling duty of care, or whether the decision is made based on a good faith; and (c) As judged from the material benefit, does the decision imply a violation of duty of loyalty by the directors. Substantively, the existence of BJR is to protect and promote the free implementation of the authority given to directors (Bainbridge, 2003).

In conclusion, the BJR principle is to function to provide a shield to directors from business risk embedded in the decision they make, as far as the presumption can be reality or facts in the court. This presumption is based on the tenet that the corporate organs have fiduciary relationship with the corporation. In that relationship, they are supposed to fulfill their legal obligations comparing the three components of fiduciary duties said earlier (Bainbridge 2003). The definition of fiduciary relationship as given by Black's Law Dictionary is as follows (Garner, 2004):

"A relationship in which one person under a duty to act for the benefit of the other on matters within the scope of the relationship. Fiduciary relationship usually arises in one of the four situations: (1) when one person places a trust in the faithful integrity of another, who as a result gains superiority or influence over the first, (2) when one person assumes control and responsibility over another, (3) when a person has a duty to act for give advice to another falling within the scope of the relationship, or (4) when there is a specific relationship that has traditionally been recognized as involving fiduciary duties".

It means that a person has an obligation to act for other's interest in the context of the relationship. The fiduciary relationship is created by one of the following conditions: when some body puts a trust based on a sincere integrity of another person, and as a result the latter person has an influence over the first person, when some body takes a supervisory role and responsibility over another person, when some body has a responsibility to give advices to another person in that relationship, or if there traditionally exists a specific relationship or habits involving *fiduciary duties*.

The word *fiduciary* has two connotations, ie trust and confidence. Based on a specific trust and confidence, a fiduciary is the person who is trusted to use the utmost good faith and fairness in dealing with the person who hires the fiduciary or the beneficiary, has some specialized knowledge or skill that is used solely for the benefit of the beneficiary; so has the obligation to report every thing openly (duty of candor). In a broader term, a fiduciary must act not for his own interest, but for the interest of other party or beneficiary; as seen as an implication of an agreement to provide a discretion to act (Johnson, 2014).

Fiduciary duties are legal duties or obligations that have to be performed by a person for whom another person or beneficiary has right to have it, based on good faith, trust, confidence, and the most sincerest honesty that have to be given by fiduciary or the trusted person solely for the sake of the beneficiary who extends the trust. In general, fiduciary duties is established, when a party is given a discretion in relation to property or important resources from other party. In relation to investment, fiduciary duties supply rules which guide the agents's implementation of those delegated responsibilities, with the goal ensuring that the fiduciary fulfills his or her obligations. Hence, the fiduciary must control and deploy the assets being trusted to him for the benefit of the beneficiary, that means to protect the interest of the beneficiary in the assets. Substantively, fiduciary duties focus on process and behavior (Bainbridge, 2005)

Like in the case of directors and corporation, it can be said that between *mudharib* and *shahibul mal* are established a fiduciary relationship. *Shahibul mal* entrusts his investment fund to *mudharib* in the hope that *mudharib* can make profit for both of them, which will be shared based on ratio that has been agreed by them. In case between directors and corporation, the relationship is governed by corporate deeds, whereas in case of *mudharib* and *shahibul mal* is stipulated in *mudharabah* contract that agreed upon. *Mudharib*, therefore, has the responsibility to fulfill his fiduciary duties, to include duty of good faith, duty of care, and duty of loyalty.

3.3 Duty of Good Faith

In Sean J. Griffith's opinion, the concept of good faith is related to duty of care and duty of loyalty. If a person works well and fulfill his fiduciary duty, it can be said then that person works prudently, and it means he works fulfilling his duty of care. As a component of duty of care, good faith can be seen as opposed to a failure of a process, that is what has to be done is not done, so created in term of avoiding an occurrence of loss.

Furthermore, if that person works with a good faith, he does not put his own personal interest which means he does not take personal financial benefits, or not doing a conflict of interest, but in the best interest of corporation, or consistent with his responsibilities, so he fulfills his duty of loyalty (Griffith, 2005).

If directors have material personal interests, which make them to become not loyal to corporation, or not to act rationally, not using relevant information which is appropriately available, which makes them not to act prudently, which means they ignore their duty of care; or if they avoid tax, so as to violate public policy or positive law, it means directors to act in bad faith, in such case they can not have BJR legal protection (Greenhow, 1999).

The concept of good faith can be seen having three categories of fiduciary conducts, all of which relates to act in bad faith as opposed to good faith, i.e.: Firstly, an intention to do harms or to create losses, or knowingly ignore his duties. Secondly, lack of duty of care, gross negligence despite no bad intention. Gross negligence itself indicates an irrational act, which also implies on neglecting one's duties as director with a value of an intention. Thirdly, neglecting duties intentionally, or knowingly neglecting one's obligation like having no attention to or fails to use material information needed in making decision (Sprague, 2007).

The Indonesian civil law, which is also applicable to *mudharabah* contract, the component of good faith is regulated by Article 1338 (3) the Indonesian Book of Civil Code (*KUHPerdata*) that says that: every agreement must be implemented in good faith. This means to do an agreement the parties can not be in contradiction to decency and justice, or the implementation must be based on truth (Abdulkadir, 2000). Islamic law also contains numerous examples of obligations that are based on good faith principle. In Islam, the same substance is contained in Qur'anic *Surah An Nisa* (Qur'anic Surah 4 Verse 29) which commands not to misappropriate your property among yourselves, *Surah Al Maidah* (Qur'anic Surah 5 Verse 1) to fulfill all contracts, and *Surah Al Baqarah* (Qur'anic Surah 2 Verse 283) to deliver the promise to one who has the right.

Good faith is the soul in understanding, preparing and implementing an agreement. Every parties in the agreement have the responsibility to investigate their counterpart in an appropriate way to confirm that the counter party indeed has an intention to close the contract in good faith. Good faith has a subjective meaning or the honesty of a person in doing a legal act, representing a mental attitude when doing the legal act. Objectively, good faith represents an execution of an agreement that has to be on the basis of decency norms that exists in the society.

Good faith is not only stressed prior to the signing of an agreement, but also in every facets of the agreement starting from the presigning so that the interests of each parties must be taken care of by each parties. The formula of good faith, long before any agreement is prepared and signed, is not at all intended to make either creditor or debtor, or even a third party outside the agreement, to be at a loss, and without negligence, coercion, and fraud, as well as not to negatively affect public interest.

According to the attachment to the Indonesian Supreme Court Decision Number 238 PK/PDT/2014, the realization of good faith in the agreement is to do the performance according to what have been agreed. Being as such, if one party does not perform up to the agreement, it means that party does not fulfill the principle of good faith. As far as that performance is not done as required by the agreement, or in *mudharabah* contract, it means *mudharib* has breached the contract, as stipulated in Article 1243 KUH Per data. The same case applies, if *mudharib* violates any law, or does negligence or mistakes, which makes *shahibul mal* to be at loss, all of these acts are governed in Articles 1365, 1366, and 1367 KUH Perdata. The Islamic National Board (DSN)'s Decree or *Fatwa* also regulates the same matter, and says in *mudharabah* contract there is no damage payment, except if it is caused intentionally by mistakes, negligence, and breach of the agreement. Article 208 Chapter VII *Mudharabah* The Compilation Book of *Syariah* Economy (KHES) mentions that business losses or the deterioration of trading goods that occur not because of *mudharib*'s negligence are for the responsibility of *shahibul mal*.

Nonetheless, as far as the loss is caused by the materialization of business risk, then it is difficult to determine whether *mudharib* shall be responsible for the said loss. In relation to BJR, the question is really related to whether *mudharib* is obligated to fulfill good faith as it applies in BJR, i.e.: (a). To work prudently, or with duty of care; (b). Act rationally, and make business decision based on relevant information that is normally available; (c). If in the process develops an indication of a loss, *mudharib* makes an effort to minimize the possible loss; (d). Not to put a personal interest in taking personal benefits, or not to do any conflict of interest. To take care of the questions (a) and (d) above, as in the relation to duty of care, in one particular *hadits*, the Prophet pbuh says that, " *You may not put other people in danger or make them losing, and not to make a revenge to do harm to pay any harm*".

What this means is that subjectively, *mudharib* surely must have an intention to make the business profitable being the common interest with *shahibul mal*. Objectively, to reflect that mental condition, *mudharib* must do his job with duty of care, and make an effort to mitigate the materialization of business risk with his knowledge, which indicates that has made an effort to avoid the loss. To achieve that, *mudharib* must follow the guidance's given by *sahibul mal* as laid out in *mudharabah* contract. The making of this effort can be used as a yardstick to indicate the existence of good faith, regardless it is successful or not.

3.4. Duty of Care

To answer the question (b) above can be approached by using the concept of duty of care. The important element of duty of care is the prudential attitude, which is measured by the action that normally done by a normal and logical person when doing his own business (Griffith, 2005). According to Douglas Bradson, the standard duty of care that being used is still due care, which means "with standard of care as a common person's duty of care in the same position who will do the same duty of care". The obligation to act with duty of care requires directors to make business decision through a process of making decision with the standard of care that used by a common person in the same condition based on the material information that is normally available. In relation to investment, this duty includes implementing prudence and care in managing the assets trusted with diversification of risk (Brandson, 2002).

The duties that have to be fulfilled by directors in the context of standard of care comprise monitoring, raising questions, making decisions prudentially where directors are obligated to choose to act, and utilizing the process of making decision properly. From the point of making BJR decision, what is important to see is how the decision is processed to be made, or the proces of making the decision, and not to see it from the substance of the decision made. Therefore, the violation of *due care* is seen from the process, not the results (Gold, 2007).

As identical to the above understanding, making a decision in Islam comprising: Firstly, to collect, record and develop the data required in the field related to the decision to be made; secondly, to find *Qur'anic* verses and Propetic *hadits* as references to be in line with the field being discussed, and to do an analysis in accordance to stipulations in the main Islamic sources of law; and thirdly, to confirm the decision made not in contradictory to the stipulations in the two Islamic sources of law. This process is also in line with the concept of *tabayyun* as revealed in *Surah An Nissa* (*Qur'anic Surah 4 Verse 94*), dan *Surah Al Hujurat* (*Qur'anic Surah 49 Verse 6*).

The word 'investigate' in the first verse, and the phrase 'to investigate calmly ' in the second verse, mean to find the clarity and the basic truth of a fact dilligently. Hamka further interprets the first verse in general, and says that making decision must be based on a mastery of the issues being faced, which is to be seen from various angles, so as to indicate a broadness of understanding, not one sided, to be based on strong evidences, not to do it callously, in order to be able to make wise decisions (Hamka, 1984). So, the interpretation of the second verse is in line with the concept of *duty of care* in BJR. In making business decision, *mudharib* must do it with duty of care, that based on data and facts that have been investigated their truth.

3.5 Duty of Loyalty

To answer the question (e) above can be approached by the concept of *duty of loyalty*. In a simple formulation, *duty of loyalty* means the obligation to keep personal interest aside, and not to do *self dealing*. *Duty of loyalty* obligates directors to make decision and act in the best interest or to act solely for the interest of the corporation, or the interest of the constituents, not for the individual (Smith, 2004). Decision is made independently based on own judgment, not just to follow the opinion of other directors, or called being *rubber stamped* (Greenhow, 1999). Traditionally, *duty of loyalty* means no conflict of interest in financial benefits. If this is alleged, what plaintiff has to prove is the transaction's value of honesty and fairness? The violation of duty of loyalty is seen not from the process, but from the results (Gold, 2007). In relation to corporation, the essence of duty of loyalty is measured by putting the interest of the corporation on top of personal, and also seen whether or not directors participate to take benefits from the decision that they have made. Thus, loyalty includes faithfulness to the interest of beneficiary and purpose of the investment and impartiality when taking different interests of beneficiary into account (Johnson, 2014).

According to Griffith, duty of loyalty starts to be questioned when conflict of interest appears between personal interest and the interest as a fiduciary in relation to a financial matter for which personal interest is put as important as not to maximize the profit for corporation. When directors take this opportunity for personal interest, more often it is done by using the established procedures. Fundamentally, *duty of loyalty* is determined by question whether a transaction is to profit the corporation, and being done openly, or at *arms' length* (Griffith, 2005).

The above clearly indicates that *duty of loyalty* essentially fiduciary like directors when making business decision, it is done independently, and not to mix the interest of the corporation with personal interest. It means, that directors are not taking financial the decision he has made. A *mudharib*, just like any other directors generally, is being entrusted investment that owned by *shahibul mal* with the objective to produce profit for *shahibul mal* and himself. In that situation, is it fair and proper, if *mudharib* firstly takes clandestinely a part of profit created and then discloses the only smaller balance to *shahibul mal*. After that, based on the ratio agreed, *mudharib* again receives his portion. Taking a portion clandestinely or without a prior approval from the investor represents *ghashab*, which includes in the category of a nasty act, which is equivalent to stealing, embezzlement, or corruption; all of which are forbidden in Islam. From fiduciary relationship viewpoint, the above act means that *mudharib* betrays *shahibul mal*, which contradicts to the principle of honesty and is very much against *hadits*. When the Prophet pbuh did the trade based on *mudharabah* contract with Siti Khadijah, the Prophet pbuh always produced profit for her as the *shahibul mal*. At the same time, the Prophet pbuh never took his portion before his master permitted him to do so. Any profit made was reported openly without any being hidden, and being counted together and delivered to *mudharib* through the hands of *shahibul mal*. In this context, it means that *mudharib* has fulfilled his *duty of loyalty*.

The issue being laid down above is a matter of *amanah*, or trust. This word *amanah* in the *Al Qur'an* and *hadits* has a depth in meaning, and becomes one of the key concepts in Islam. Surah *Al Maidah* (*Qur'anic Surah 5 Verse 1*) instructs human beings to fulfill and perfect their bonds or their promises or their contracts. Surah *Al Baqarah* (*Qur'anic Surah 2 Verse 283*) says that, "So that person who is given mandate must fulfill his duty and fear of Allah". Taking a profit portion beyond what has been agreed falls under the category of being forbidden or *haram* (Hamka, 1984).

Surah An Nisa (*Qur'anic Surah 4 Verse 29*) says that, "Do not to eat other's wealth among you in a wrong way, except through trade based on the fact that both of you like to do it". Based on Ibnu Katsir's interpretation, the phrase 'to eat in wrong way' means a variety of ways with a full of cheating, except through the way that blessed based on what has been agreed. What is agreed is based on offer or *Ijab* and acceptance or *Kabul*, which serves as the basis of entering into an agreement or contract. In the field of trade, *Amanah* or trust means also to act honestly, which is being supported with transparency or *tabligh*; all of these elements correlate in turn to each another. All of the traits have been shown in the personal characters of the Prophet pbuh, including during his time in business. In view of the above, the BJR doctrine can be implemented in *mudharabah* contract, based on the following. Firstly, between *shahibul mal* and *mudharib* establish a fiduciary relationship, because *shahibul mal* entrusts his investment fund and relies his expectation on *mudharib* for profit from the business that fully managed by *mudharib*. Secondly, having the fiduciary relationship, theoretically, *mudharib* is obligated to do his fiduciary duties, comprising duty of good faith, duty of care, and duty of loyalty. Thirdly, the important meanings of the three fiduciary duties are also contained in some Qur'anic verses, as also interpreted by the authoritative Islamic scholars.

The implementation of the BJR doctrine in *mudharabah* contract can indicate clearly whether *mudharib* has tried to do his best in managing the business by fulfilling his three fiduciary duties. If so, *shahibul mal* can be assured that a report of business loss is due to the materialization of business risk, so that *mudharib* is free from the responsibility for the damage, and therefore he is freed from court allegation. In BJR, *mudharib* can be freed from such responsibility, only if he has done his fiduciary duties. Firstly, *mudharib* has shown his duty of good faith, by showing that he has made the effort sincerely to fulfill his contractual obligation and a serious effort by using his business expertise to avoid or to minimize the business risk, despite the failure to achieve the positive results. Secondly, *mudharib* has fulfilled his *duty of care*, if he has made his decisions carefully by using relevant data and facts that have been investigated, or has implemented the concept of *tabayyun*. Thirdly, *mudharib* has fulfilled his *duty of loyalty*, by acting honestly, or not taking personal benefits clandestinely.

To ensure the benefit of *shahibul mal* and *mudharib*, based on the principle of freedom to contract, *mudharib* and *shahibul mal* can agree to include the clauses relating to the three fiduciary duties. The freedom to contract is allowed in Islam, which includes the clauses needed, but with the limit not to eat ones wealth wrongly. The freedom to contract is reflected in *Surah Al Maidah* (*Qur'anic Surah 5 Verse 1*) that says, " Fulfill contracts."

This verse is in line with Article 1338 (1) KUH Perdata, “*All agreement that made valid serve as the law for those who have agreed, or Pacta Sunt Servanda*”. Based on the Syaikh al Utsaimin’s narration, one *hadits* says that it is allowed to make conditions in *mudharabah*; and if no such conditions, if there is conflict, it can be burdened to *shahibul mal* (Al Khalali, 2011).

4. Conclusion

One of the obvious problems in *mudharabah* causing a low usage of the contract is a possible occurrence of moral hazard done by *mudharib* or the entrepreneur. Because the loss due to business risk becomes the responsibility of *shahibul mal* or the financier, *mudharib* has the opportunity to report a lower profit or loss. To overcome this moral hazard problem, the doctrine of BJR with its fiduciary duties, duty of good faith, duty of care and duty of loyalty, can be adopted and implemented in *mudharabah* contract. It is in line with the Islamic law, because the essences of those duties are contained in the concepts of *tabayyun* and *amanah* in Islam. These duties can be specified in clauses of the contract as mutually agreed by both *mudharib* and *shahibul mal*. To show he has fulfilled the duty of good faith, *mudharib* has to fulfill the other two duties at the same time. First, he has made an effort to mitigate the business risk using carefully the available information or doing *tabayyun*, showing that he has done his duty of care which emphasizes on the process and not on the result. Secondly, he does not take any financial benefit for himself in the venture while reporting a loss with the reason of business risk materialization, as seen in the result, not the process. This serves as a proof that he has kept his duty of loyalty intact or being *amanah* to the contract and *shahibul mal*. Then, he can be freed from the legal responsibility for the loss due to business risk. With these two fulfillments, the possible moral hazard can be kept aside, and one of the problems in using *mudharabah* contract can be solved. Thus, it can be expected that the usage can be more frequent

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